

SPENCER MUNICIPAL UTILITIES
INDEPENDENT AUDITORS' REPORTS
FINANCIAL STATEMENTS
AND SUPPLEMENTAL INFORMATION
DECEMBER 31, 2006

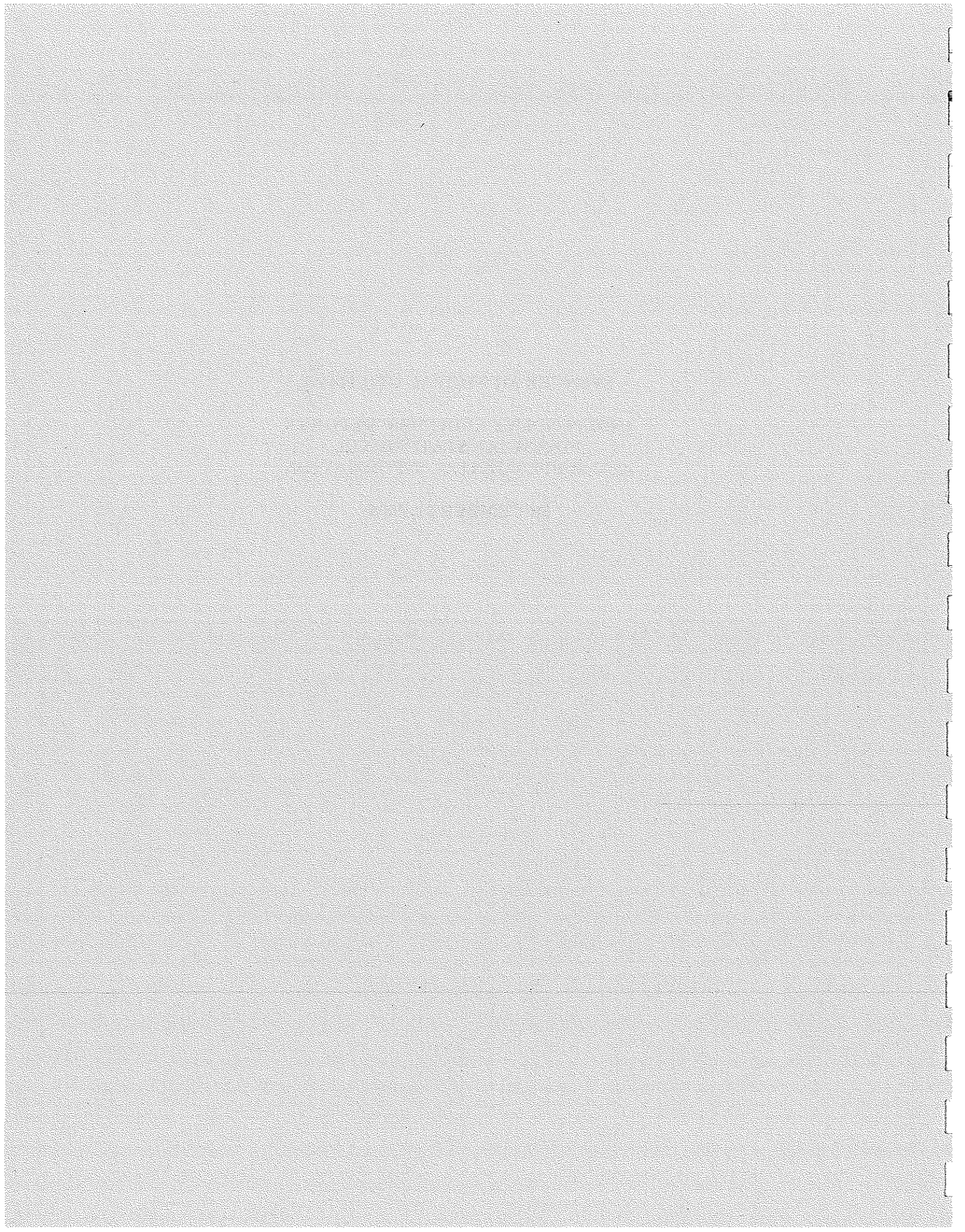


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SPENCER MUNICIPAL UTILITIES

OFFICIALS

DECEMBER 31, 2006

<u>Board of Trustees</u>		<u>Term Expires</u>
Murray Hart	Treasurer	6-30-2007
Tom Howe	Trustee	6-30-2008
Dave Hultgren	Vice-Chairman	6-30-2011
Bruce Tamisiea	Chairman	6-30-2010
Gary Tolzmann	Secretary	6-30-2012
 <u>Management</u>		
Leon Rodas	General Manager	
Steven Pick	Business Manager	

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SPENCER MUNICIPAL UTILITIES

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA**

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INDEPENDENT AUDITORS' REPORT

Board of Trustees
Spencer Municipal Utilities – Municipal Electric Utility
Spencer, IA 51301

We have audited the accompanying balance sheet of the Municipal Electric Utility of the City of Spencer, Iowa (the Utility) as of December 31, 2006 and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Utility's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Utility as of December 31, 2006, and the respective changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 20, 2007 on our consideration of the Utility's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis and budgetary comparison information on pages 3 through 6 and 23 through 25 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurements and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Williams & Company, P.C.
Certified Public Accountants

Spencer, Iowa
March 20, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

The purpose of Management's Discussion and Analysis (MD&A) is to provide the reader with an introduction to the financial statements. Our discussion and analysis of the Municipal Electric Utility (Utility) of the City of Spencer, Iowa's financial performance provides an overview of the Utility's financial activities for the year ended December 31, 2006.

The following information should be read in conjunction with the financial statements and the accompanying notes to the financial statements that follow this section.

2006 Financial Highlights

The Utility delivered approximately 159,121,000 kilowatt hours (kWh) of electricity to its retail customers in 2006 compared to approximately 152,258,000 kWh in 2005.

The Utility's net assets increased \$1,973,904 to \$46,554,878 as a result of operations for the year ended December 31, 2006.

Overview of the Financial Statements

The balance sheet includes the Utility's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities).

The statement of revenues, expenses and changes in net assets reports all revenues and expenses incurred during the fiscal year.

The statements of cash flows present cash receipts, cash disbursements, and net changes in cash resulting from operations, capital and related financing activities and investing activities.

The notes to the financial statements provide the required disclosures and other information that is necessary to give the reader a complete understanding of the data provided in the statements. The notes present information about the Utility's accounting policies, material risks, obligations, commitments, contingencies and subsequent events.

MANAGEMENT'S DISCUSSION AND ANALYSIS -Continued

Condensed Financial Information

The following condensed financial information serves as the key financial data and indicators for management, monitoring, and planning.

Condensed Balance Sheet

	<u>2006</u>	<u>2005</u>
Current assets	\$ 2,327,888	\$13,772,356
Capital assets, net of depr.	37,110,284	31,502,348
Noncurrent assets	21,384,467	14,833,523
Deferred costs	<u>154,234</u>	<u>168,559</u>
Total assets	<u>60,976,873</u>	<u>60,276,786</u>
Current liabilities	2,081,995	2,370,812
Long-term debt	<u>12,340,000</u>	<u>13,325,000</u>
Total liabilities	<u>14,421,995</u>	<u>15,695,812</u>
Investments in capital assets, net of related debt	23,939,518	17,222,348
Restricted	2,467,845	4,578,986
Unrestricted	<u>20,147,515</u>	<u>22,779,640</u>
Total net assets	<u>46,554,878</u>	<u>44,580,974</u>
Total liabilities and net assets	<u>\$60,976,873</u>	<u>\$60,276,786</u>

Condensed Statement of Revenues, Expenses and Changes in Net Assets

	<u>2006</u>	<u>2005</u>
Sales of electricity	\$10,174,902	\$8,726,584
Other	<u>163,665</u>	<u>153,923</u>
Total operating revenue	<u>10,338,567</u>	<u>8,880,507</u>
Power supply costs	6,114,337	6,542,381
Distribution system maintenance	1,229,262	1,417,250
Depreciation & amortization	1,796,460	1,726,612
Customer service & administration	<u>725,187</u>	<u>724,908</u>
Total operating expenses	<u>9,865,246</u>	<u>10,411,151</u>
Operating income (loss)	473,321	(1,530,644)
Interest income	1,157,578	830,385
Interest expense	(332,973)	(356,410)
Other income	<u>675,978</u>	<u>603,207</u>
Total non-operating revenues	<u>1,500,583</u>	<u>1,077,182</u>
Change in net assets	<u>1,973,904</u>	<u>(453,462)</u>
Net assets, beginning of year	<u>44,580,974</u>	<u>45,034,436</u>
Net assets, end of year	<u>\$46,554,878</u>	<u>\$44,580,974</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS --Continued

Financial Analysis

The Utility's total assets decreased by approximately \$700,000.

The Utility's gross revenues increased by approximately \$1,458,000 or 16.42%.

Power supply costs have decreased by approximately \$428,000. Total operating expenses decreased by approximately \$187,000 due to decreased expenses related to distribution maintenance. Depreciation and amortization also increased by approximately \$70,000.

Total operating income generated in 2006 was \$473,321 compared to an operating loss of \$1,530,644 in 2005.

Utility non-operating income (expense) resulted in an additional \$1,500,583 of income due to additional leases of utility facilities and a higher rate of return on invested funds.

Total net income (loss) increased from a net loss of \$453,461 in 2005 to a net income of \$1,973,904 in 2006.

Capital Assets and Debt Administration

Net capital assets increased by approximately \$5,594,000 due to construction work in progress related to the Council Bluffs Energy Center Unit 4 (CBEC #4), Wisdom 2, distribution construction, and equipment purchases.

During August of 2002, the Board of Trustees entered a joint ownership agreement for the construction of the Council Bluffs Energy Center Unit 4. The Utility will become a 1.07% owner which is 8.453 megawatts. The Utility's total ownership interest is estimated at \$13,600,000. The Utility's construction work in progress totaled approximately \$10,771,000 at year end.

On February 1, 2004, the Board of Trustees authorized the issuance of \$8,750,000 in Electric Revenue Bonds, Series 2004. The proceeds from these bonds will be used to finance a portion of the construction of the Council Bluffs Energy Center Unit 4 discussed above. During the year ended December 31, 2006, the remaining balance of the bond proceeds fund were used to pay for construction costs.

Economic Factors

The Utility continues to experience stability in retail sales. In order to cover more of its base load capacity, the Board of Trustees has entered into a joint ownership agreement for the construction of the CBEC #4.

The Utility completed a Cost of Service Study during 2004. The purpose of the study was to assign operating and capital costs to the various rate classes and verify that rates were adequate to cover those costs. The Board of Trustees adopted rate adjustments based on the study effective March 1, 2005. The utility also adopted an Energy Cost Adjustment (ECA) for all consumption beginning September 7, 2005. The ECA is calculated monthly and is designed to recoup the additional costs of power supply from the consumer.

MANAGEMENT'S DISCUSSION AND ANALYSIS –Continued

Contacting the Utility's Financial Management

This financial report is designed to present our citizens, customers, and creditors with a general overview of the Utility's finances and operating activities. If you have any questions or require additional information please contact the Business Manager, 712 Grand Ave, PO Box 222, Spencer, Iowa 51301.

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
BALANCE SHEET
DECEMBER 31, 2006**

ASSETS

Capital Assets:

Plant in Service	\$ 53,335,210
Accumulated Depreciation	(26,995,655)
Net Plant in Service	<u>26,339,555</u>
Construction in Progress	<u>10,770,729</u>

Total Capital Assets

37,110,284

Noncurrent Assets

Restricted Cash and Cash Equivalents	
Restricted	130,865
Consumer Deposits	20,931
Noncurrent Investments:	
Unrestricted	2,967,095
Board Designated	10,381,000
Restricted	2,336,980
Notes Receivable - Employees	1,596
Notes Receivable -Municipal Communications Utility	<u>5,546,000</u>

Total Noncurrent Assets

21,384,467

Current Assets:

Cash and Cash Equivalents	
Unrestricted	(1,391,933)
Board Designated	1,255,630
Accounts Receivable (Net of Allowance for Doubtful Accounts of \$30,000)	960,394
Unbilled Usage	464,538
Materials And Supplies Inventory	609,399
Fuel Inventory	182,623
Notes Receivable - City of Spencer	26,625
Notes Receivable - Employees	4,378
Prepayments and Other	<u>216,234</u>

Total Current Assets

2,327,888

Deferred Costs:

Unamortized Bond Issue Costs	<u>154,234</u>
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Total Assets

\$ 60,976,873

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
BALANCE SHEET
DECEMBER 31, 2006**

LIABILITIES AND NET ASSETS

Bonds Payable:	
Bonds Payable	\$ 13,325,000
Less - Current Maturities	<u>(985,000)</u>
Total Bonds Payable	<u>12,340,000</u>
Current Liabilities:	
Accounts Payable	796,665
Payroll and Sales Tax Payable	42,421
Accrued Payroll and Compensated Absences	188,206
Accrued Interest Payable	48,772
Consumer Deposits	20,931
Current Maturities of Long-Term Debt	<u>985,000</u>
Total Current Liabilities	<u>2,081,995</u>
Total Liabilities	<u>14,421,995</u>
Net Assets	
Invested in Capital Assets, Net of Related Debt	23,939,518
Restricted	2,467,845
Unrestricted	<u>20,147,515</u>
Total Net Assets	<u>46,554,878</u>
Total Liabilities and Net Assets	<u><u>\$ 60,976,873</u></u>

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**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
STATEMENT OF REVENUES, EXPENSES AND
CHANGES IN FUND NET ASSETS
FOR THE YEAR ENDED DECEMBER 31, 2006**

Operating Revenues:	
Residential	\$ 3,413,558
Commercial	4,694,434
Public Authorities	649,182
Sales for Resale	123,038
Energy Cost Adjustment Revenue	1,417,728
Penalties	17,189
Miscellaneous	23,438
	<hr/>
Total Operating Revenues	10,338,567
Operating Expenses:	
Generation and Transmission	
Neal #4 Fuel and Generation	784,865
Purchased Power	5,211,987
Other	117,485
Distribution	1,229,262
Depreciation and Amortization	1,796,460
Customer Operations	258,304
General and Administrative	466,883
	<hr/>
Total Operating Expenses	9,865,246
Operating Income	473,321
Non-Operating Income (Expense):	
Interest Income on Investments	1,157,578
Economic Development Payment	(44,036)
Leased Facilities	1,156,112
Interest Expense	(332,973)
Loss on Plant Retirements	(14,478)
Payment in Lieu of Property Taxes	(421,620)
	<hr/>
Total Non-Operating Income (Expense)	1,500,583
Change in Net Assets	1,973,904
Net Assets at Beginning of Year	44,580,974
	<hr/>
Net Assets at End of Year	\$ 46,554,878

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2006**

Cash Flows From Operating Activities:

Cash Received From Customers	\$ 10,240,449
Cash Payments to Suppliers for Goods and Services	(8,101,516)
Cash Payments to Employees for Services	(514,461)

Net Cash Provided By Operating Activities	1,624,472
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Cash Flows From Noncapital Financing Activities:

Contributions Paid for Economic Development	(44,036)
Payment in Lieu of Property Taxes	(421,620)

Net Cash (Used) By Noncapital Financing Activities	(465,656)
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Cash Flows From Capital and Related

Financing Activities:

Acquisition & Construction of Property and Equipment	(7,404,549)
Revenue Bond Principal Repayment	(955,000)
Payments Received From Leasing of Facilities	1,156,112
Interest Paid	(335,827)

Net Cash (Used) By Capital and Related Financing Activities	(7,539,264)
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Cash Flows From Investing Activities:

Payments Received on Note Receivable -City of Spencer	26,625
Loan Advances for Note Receivable Employee	(1,094)
Payments Received on Note Receivables - Communications	1,000,000
Proceeds From Redemption of Investments	8,738,543
Purchase of Investments	(16,162,720)
Interest Received From Investments	1,157,578

Net Cash (Used) By Investing Activities	(5,241,068)
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Net (Decrease) in Cash	(11,621,516)
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Cash at Beginning of Year	11,637,009
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Cash at End of Year	\$ 15,493
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Reconciliation:

Cash and Cash Equivalents

Unrestricted	\$ (1,391,933)
Board Designated	1,255,630
Restricted	130,865
Consumer Deposits	20,931

	\$ 15,493
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**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
STATEMENTS OF CASH FLOWS (CONTINUED)
FOR THE YEAR ENDED DECEMBER 31, 2006**

**Reconciliation of Operating Income to Net
Cash Provided by Operating Activities**

Operating Income	\$ 473,321
Adjustments to Reconcile Operating Income to Net Cash Provided By Operating Activities	
Depreciation and Amortization	1,796,460
(Increase) Decrease in Operating Assets:	
Accounts Receivable	(80,266)
Unbilled Usage	(19,273)
Materials and Supplies Inventory	(34,262)
Fuel Inventory	(48,353)
Prepayments	(147,193)
Increase (Decrease) in Operating Liabilities:	
Accounts Payable	(267,596)
Accrued Payroll and Compensated Absences	(47,578)
Consumer Deposits	1,421
Accrued Expenses	(2,209)
Total Adjustments	<u>1,151,151</u>
Net Cash Provided By Operating Activities	<u><u>\$ 1,624,472</u></u>

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Organization and Basis of Accounting

The Municipal Electric Utility of the City of Spencer, Iowa (Electric Utility or Utility) operates as an independent unit of the City of Spencer and is managed, along with the Municipal Water Utility and the Municipal Communication Utility of the City of Spencer, Iowa, by a five member Board of Trustees.

The Utility follows the accounting practices prescribed through the Federal Energy Regulatory Commission for regulated utilities and proprietary fund accounting for governmental entities under accounting principles generally accepted in the United States of America.

For financial reporting purposes, the Utility has included all funds. The Utility has also considered all potential component units for which it is financially accountable, and other organizations for which the nature and significance of their relationship with the Utility are such that exclusion would cause the Utility's financial statements to be misleading or incomplete. The Governmental Accounting Standards Boards has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the Utility to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific financial burdens on the Utility. It was determined that the Utility has no component units.

The Utility is not considered to be a component unit of the City of Spencer for financial statement purposes. An audit of the City of Spencer for the year ended June 30, 2006 has been completed and is filed under separate cover.

The Utility's financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when liability is incurred, regardless of the timing of related cash flows.

In reporting the financial activity of its enterprise fund, the Utility applies all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Boards Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure

The Utility distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Utility's principal ongoing operations. The principal operating revenues of the Utility are charges to customers for sales and services. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

B. Capital Assets and Depreciation

Capital assets are stated at original cost when first devoted to public service. Currently, such costs include labor-related expenditures, such as payroll taxes, pensions, and other fringe benefits and administrative costs for labor related to the construction of new electric facilities. In addition, net interest costs on construction debt are capitalized. During 2006, the Utility capitalized interest expense of \$268,365, which equals total interest expense of \$284,538 less interest income from invested proceeds of \$16,173.

Under a joint ownership agreement with other utilities, the Electric Utility has a 1.215% undivided interest in a 644 MW electric generation station known as George Neal Generating Station Unit No. 4. The Electric Utility's 1.215% ownership interest in this plant represents a total investment of \$4,866,073 included in utility plant in service with \$3,580,463 included in accumulated depreciation. Operating costs associated with this plant and depreciation are reflected in the statement of income.

Under a joint ownership agreement with other utilities, the Electric Utility has a 1.07% undivided interest in and electric generation station known as Council Bluffs 4, which is currently under construction with expected completion in 2007. Additional information is included in Note 15.

Replacements and betterments of capital assets are charged to capital assets. Routine maintenance and repairs are charged to expense as incurred.

Depreciation is provided on a straight-line basis. Current depreciation expense is approximately 3.36% of the original cost of depreciable electric plant in service.

The estimated useful lives used to depreciate assets by class are as follows:

Infrastructure	20-33 years
Building and improvements	20 years
Equipment	5 years

C. Accounts Receivable

Accounts receivable are stated at the amount the Utility expects to collect from outstanding balances. The Utility provides for probable uncollectible amounts through a charge to earnings and a credit to valuation allowance based on its assessment the current status of individual accounts. Balances that are still outstanding after the Utility has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. Changes in the valuation allowance have not been material to the financial statements.

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. Inventories

Inventories are valued at the lower of cost or market. The average cost method is used for determining the cost of materials and supplies inventory. Inventories are recorded as an expenditure or, if applicable, capitalized when consumed.

E. Unamortized Bond Issue Costs

Unamortized debt issue costs are amortized over the life of the debt on a straight-line basis which approximates the effective interest method.

F. Net Assets

Net assets represent the difference between assets and liabilities in the financial statements. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used for acquisition, construction or improvement of those assets and increased by unspent proceeds. Net assets are reported as restricted when there are limitations imposed on their use through external restrictions imposed by creditors, grantors or laws or regulations of other governments.

G. Income Taxes

The Electric Utility is exempt from federal and state income taxes because it is a governmental entity organized under the provisions of Chapter 388 of the Code of Iowa.

H. Revenues and Unbilled Usage

Revenues are based on billing rates, which are applied to customers' consumption of electricity. The Utility records estimated unbilled revenue at the end of accounting periods. Revenues earned, but not yet billed at December 31, 2006, totaled \$464,538.

I. Estimates

The preparation of the financial statements in conformity in U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 2 - CASH AND CASH EQUIVALENTS AND NONCURRENT INVESTMENTS

The Utility's deposits in Banks at December 31, 2006 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

The Utility is authorized by statute and Board of Trustees' approval to invest public funds in obligations of the United States government, its agencies, and instrumentalities; certificates of deposit and other evidences of deposit at federally insured Iowa depository institutions; and the Iowa Public Agency Investment Trust.

The Utility had investments in Iowa Public Agency Investment Trust which are valued at an amortized cost of \$4,828,620 in pursuant to Rule 2a-7 under the Investment Company Act of 1940.

Interest Rate Risk -- The Utility's investment policy limits the investment of operating funds (funds expected to be expended in the current budget year or within 15 months of receipt) in instruments that mature within 397 days. Funds not identified as operating funds may be invested in investments with maturities longer than 397 days, but the maturities shall be consistent with the needs and use of the Utility.

Credit Risk -- The Utility's investment in the Iowa Public Agency Investment Trust is unrated.

The Utility considers all highly liquid investments with an original maturity of three months or less to be cash equivalents for purposes of the statement of cash flows.

Investments are recorded at cost which approximates market. Adjustments are made to cost for any premium or discount, which is amortized over the maturity of the investment. Adjustments are also made to account for the change in accrued interest on respective investments.

Reconciliation of the Utility's cash and cash equivalents and noncurrent investments is as follows:

Cash and cash equivalents:

Board designated	\$ 1,255,630
Consumer Deposits	20,931
Restricted	130,865
Unrestricted	(1,391,933)
Total cash and cash equivalents	<u>15,493</u>

Noncurrent investments:

Unrestricted	2,967,095
Board designated	10,381,000
Restricted	2,336,980
Total noncurrent investments	<u>15,685,075</u>
Total cash and cash equivalents and noncurrent investments	<u>\$ 15,700,569</u>

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 3 - BOARD DESIGNATED FUNDS

The Board of Trustees of the Utility has designated certain funds to be placed in a contingency reserve account. These funds, which are from unrestricted net assets, are being designated for contingencies such as a natural disaster, and cannot be expended without Board approval.

The Board of Trustees of the Utility has designated certain funds to be placed in a replacement and construction reserve account. These funds, which are from unrestricted net assets, are being designated for replacement of property, plant and equipment and for new construction. These funds cannot be expended without Board approval.

Assets of the funds as of December 31, 2006 are summarized as follows:

	Contingency Reserve	Replacement and Construction Reserve	Total
Cash and cash equivalents	\$ 1,255,630	\$ -	\$ 1,255,630
Noncurrent investments	-	10,381,000	10,381,000
Total	\$ 1,255,630	\$ 10,381,000	\$ 11,636,630

Note 4 - CAPITAL ASSETS

Capital assets activity for the year ended December 31, 2006 was as follows:

	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital assets not being depreciated:				
Land	\$ 86,092	\$ -	\$ -	\$ 86,092
Construction in progress	7,252,585	3,768,151	(250,007)	10,770,729
Total capital assets not being depreciated	7,338,677	3,768,151	(250,007)	10,856,821
Capital assets being depreciated:				
Infrastructure	43,645,357	3,311,679	(72,228)	46,884,808
Buildings and improvements	765,876	-	-	765,876
Equipment	5,209,858	571,604	(183,028)	5,598,434
Total capital assets being depreciated	49,621,091	3,883,283	(255,256)	53,249,118
Less accumulated depreciation	25,457,420	1,782,136	(243,901)	26,995,655
Total capital assets being depreciated - net	24,163,671	2,101,147	(11,355)	26,253,463
Capital assets - net	\$31,502,348	\$ 5,869,298	\$ (261,362)	\$37,110,284

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 5 - NOTES RECEIVABLE - EMPLOYEES

The Board of trustees has authorized the Electric Utility to purchase personal computers for interested employees. The employees repay the Utility through payroll withholding over a maximum of 24 months. No interest is charged on the unpaid balance.

Note 6 - TRANSFERS IN LIEU OF PROPERTY TAXES/NOTE RECEIVABLE

By resolution of the Board of Trustees, voluntary transfers in lieu of property taxes are made to the City of Spencer, Iowa. Currently, transfers approximate 5% of gross sales (excluding the energy cost adjustment), less actual property taxes paid (on the George Neal Generating Station Unit No. 4) and returned to the City of Spencer, Iowa. Additionally, funds declared to be surplus can be, and have been, transferred to the City.

During 1996, the Utility advanced the City \$355,000, of which \$266,250 was a loan, to perform public improvements in the area of West 11th Street in Spencer. The City reimburses the Utility in equal payments of \$26,625 without interest, payable annually on July 1. The balance of this note at December 31, 2006 was \$26,625.

Note 7 - NOTE RECEIVABLE - MUNICIPAL COMMUNICATIONS UTILITY

The Board of Trustees has approved an \$8,000,000 line of credit for the Municipal Communications Utility for use in start-up and construction costs related to bringing the Communications Utility into operation. The balance of the line of credit at December 31, 2006 was \$5,546,000. Outstanding balances bear interest at a rate of 4.5% per annum.

Note 8 - BONDS PAYABLE

Bonds payable activity for the year ended December 31, 2006 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Series 2000 revenue bonds	\$ 6,010,000	\$ -	\$ 465,000	\$5,545,000	\$490,000
Series 2004 revenue bonds	8,270,000	-	490,000	7,780,000	495,000
Total revenue bonds	<u>\$14,280,000</u>	<u>\$ -</u>	<u>\$ 955,000</u>	<u>\$13,325,000</u>	<u>\$985,000</u>

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 8 – BONDS PAYABLE (Continued)

The Series 2000 and 2004 revenue bonds require annual principal payments, due December 1, and semiannual interest payments, due June 1 and December 1. Interest rates throughout the term of the bonds range between 1.4% and 5.75 %. The bonds are secured by the future net revenues of the Utility. Long-term debt matures and bears interest as follows:

	Series 2000		Series 2004	
	Principal	Interest	Principal	Interest
2007	\$ 490,000	\$ 309,292	\$ 495,000	\$ 275,963
2008	515,000	282,343	510,000	265,567
2009	545,000	254,018	520,000	253,583
2010	575,000	224,042	535,000	239,802
2011	610,000	192,418	550,000	224,288
2012-2016	2,810,000	410,270	3,040,000	823,157
2017-2019	-	-	2,130,000	187,640
Total	\$ 5,545,000	\$ 1,672,383	\$ 7,780,000	\$ 2,270,000

The bond resolutions provide certain covenants relating to the collection, segregation, and distribution of revenues from customers; places certain restrictions on future borrowing and leasing or disposition of assets; and requires that minimum insurance coverage be maintained.

Restricted Funds

Outstanding Electric Revenue Bonds are collateralized by the revenue of the Utility and the various special funds established by bond covenants. The covenants provide that the revenue of the Utility is to be used first to pay operating and maintenance expenses of the system and second to establish and maintain the special funds. Remaining revenues may then be used for any lawful purpose. The covenants also contain provisions which, among other items, restrict the issuance of additional revenue bonds unless the special funds noted above contain the required amounts and certain financial ratios are met. The Utility is in compliance with all significant financial requirements as of December 31, 2006.

At December 31, 2006, the special funds consisted of the following:

	Cash and Cash Equivalents	Noncurrent Investments	Total
Bond Sinking Fund	\$ 130,865	\$ -	\$ 130,865
Bond Reserve Fund	-	1,585,655	1,585,655
Bond Improvement Fund	-	751,325	751,325
Total Restricted Net Assets	\$ 130,865	\$ 2,336,980	\$ 2,467,845

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 8 – BONDS PAYABLE (Continued)

Monthly deposits into two bond sinking funds are required to establish the amount necessary to pay the next installments of principal and interest on the 2000 and 2004 Electric Revenue Bonds. Bond reserve funds for the 2000 and 2004 Electric Revenue Bonds equaled the required balance at December 31, 2006; therefore monthly deposits into the fund are not currently required. These funds may be used to pay principal and interest payments when insufficient funds are available in the sinking fund.

The bond improvement fund balance at December 31, 2006 equaled the minimum balance required; therefore monthly deposits into the fund are not currently required. These funds are to be used first for principal and interest payments when insufficient funds are available in the sinking and reserve funds and second for extraordinary unbudgeted maintenance expenses or system repairs, renewals and replacements.

Note 9 - RATE MATTERS

Rates of the Utility are established by the Board of Trustees and, as a municipal system, are not subject to the regulation of the Utilities Division of the Department of Commerce of the State of Iowa.

Note 10 - NUMBER OF METER CONNECTIONS

The number of meter connections totaled 5,883 at December 31, 2006.

Note 11 - LEASES

The Utility leases electrical generation capacity of a jet turbine generator, its share of the Neal 4 plant, and its share of the Wisdom 2 plant under operating leases to other utilities or their associations. The revenues from such leases are classified as leased facilities. The Utility's investment in these facilities is included in capital assets in service and is set forth as follows:

Jet turbine generator	\$ 2,537,488
Neal 4 plant	4,885,735
Wisdom 2 plant	2,314,530
Total	<u>9,737,753</u>
Less accumulated depreciation	<u>5,767,977</u>
Net investment	<u>\$ 3,969,776</u>

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 11 - LEASES (Continued)

The lease of the Neal 4 and Wisdom 2 plant are long-term commitment based on capacity. The amount is determined by formula based on usage and totaled \$322,386 and \$212,794, respectively, in 2006. The leases of the jet turbine generator are both by non-cancelable lease and a variable lease determined by capacity and totaled \$161,771 in 2006. The following is a schedule of future minimum rentals on non-cancelable operating leases on the jet turbine generator as of December 31, 2006:

2007	\$ 65,000
2008	65,000
2009	65,000
2010	65,000
2011	65,000
Total minimum lease payment receivable	<u>\$ 325,000</u>

The Utility leases bandwidth, property, and building space to the Water Utility and Communications Utility. The revenues from such leases are classified as leased facilities and totaled \$409,337 in 2006. The leases are 20-year variable leases based on bandwidth and space utilized. At December 31, 2006, \$3,049 is recorded as a receivable.

The Utility leases building space from the Water Utility. The expense from the lease is classified as operating expense. The lease is a monthly lease based on building space utilized and totaled \$8,004 in 2006. At December 31, 2006, \$663 is recorded as a payable.

Note 12 - RETIREMENT SYSTEM

IPERS

The Utility contributes to the Iowa Public Employees Retirement System (IPERS) which is a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits which are established by state statute to plan members and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, PO Box 9117, Des Moines, Iowa, 50306-9117.

Plan members are required to contribute 3.70% of their annual covered salary and the Utility is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The Utility's contributions to IPERS for the years ended December 31, 2006, 2005 and 2004 were \$87,914, \$85,741, and \$75,592, respectively, equal to the required contributions for each year.

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 12 - RETIREMENT SYSTEM (Continued)

Employees Pension Plan

All full-time employees of the Electric Utility who have completed six months of continuous employment and are 21 years of age are eligible to participate in a Money Accumulation Pension Plan administered by Copeland Plan services. The Plan is a defined contribution plan of the money purchase type, intended to qualify under Internal Revenue service Code Section 401(a), funded by a combination of employee and employer contributions. Employees electing to participate are required to contribute 2% of their compensation, and they may contribute an additional amount of not less than 1% and not more than 10% of their compensation. The Utility contributes 8% of the employees' compensation for all employees electing to participate.

The Electric Utility's contribution to the Money Accumulation Pension Plan for 2006 totaled \$132,752.

Note 13 - RISK MANAGEMENT

The Electric Utility is exposed to various risks of loss related to torts; theft, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by the purchase of commercial insurance. The Utility assumes liability for any deductible and claims in excess of coverage limits. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years. The Utility, as is typical in the electric power industry, does not insure its transmission lines due to the high cost of such coverage.

Note 14 - RELATED PARTIES

The Electric Utility, Water Utility and Communications Utility of the City of Spencer, Iowa exchange services in the normal course of business.

Two members of the Board of Trustees hold non-controlling interests in a financial institution where the Utility maintains cash balances.

Additional related party items are included in Notes 7 and 11.

Note 15 - COMMITMENTS

During 2003, the Electric Utility entered into an agreement to purchase a 1.07% ownership in the generating facilities at Council Bluffs 4. The plant is expected to be in production in 2007. The commitment of Spencer Municipal Utilities, in order to maintain its percentage of ownership, is expected to approximate \$13,600,000. Approximately \$9,584,049 had been paid or accrued resulting in a future commitment of approximately \$4,015,951. Future payments by the Utility would be required as construction progresses.

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 15 – COMMITMENTS (Continued)

During 2006, the Electric Utility entered into an economic development loan funding agreement with the City of Spencer. The Utility agreed to loan to the City \$475,000 of which none has been advanced as of December 31, 2006. The purpose of the loan is to fund the economic development loan to Shine Bros. Corp.

During 2005, the Electric Utility provided a letter of support to continue funding Iowa Great Lakes Corridor of Opportunity at a level of \$12,500 per year for four years.

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
BUDGETARY COMPARISON SCHEDULE OF RECEIPTS, DISBURSEMENTS
AND CHANGES IN NET ASSETS - BUDGET AND ACTUAL (CASH BASIS)
REQUIRED SUPPLEMENTARY INFORMATION
FOR YEAR ENDED DECEMBER 31, 2006**

	Budgeted Amounts		Actual	Final to Actual Variance
	Original	Amended		
Receipts:				
Municipal Electric Utility			\$ 13,577,922	
Municipal Water Utility			1,067,281	
Municipal Communications Utility			7,775,827	
Total Receipts	\$ 20,622,000	\$ 23,359,250	22,421,030	\$ 938,220
Expenditures:				
Municipal Electric Utility			17,776,682	
Municipal Water Utility			1,490,498	
Municipal Communications Utility			5,772,135	
Total Expenditures	25,497,730	25,333,464	25,039,315	294,149
Excess (Deficiency) of Revenues Over Expenditures	(4,875,730)	(1,974,214)	(2,618,285)	644,071
Other Financing Sources (Uses);				
Transfers In	-	-	-	-
Transfers Out	(2,000,000)	(2,250,000)	-	(2,250,000)
Total Other Financing Sources (Uses)	(2,000,000)	(2,250,000)	-	(2,250,000)
Net Change in Net Assets	(6,875,730)	(4,224,214)	(2,618,285)	(1,605,929)
Net Assets at Beginning of Year	32,087,108	32,087,108	25,723,701	6,363,407
Net Assets at End of Year	\$ 25,211,378	\$ 27,862,894	\$ 23,105,416	\$ 4,757,478

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
BUDGET TO GAAP RECONCILIATION
REQUIRED SUPPLEMENTARY INFORMATION
FOR YEAR ENDED DECEMBER 31, 2006**

	Cash Basis	Accrual Adjustments	Accrual Basis
Receipts:			
Municipal Electric Utility	\$ 13,577,922	\$ 925,665	\$ 12,652,257
Municipal Water Utility	1,067,281	(185,827)	1,253,108
Municipal Communications Utility	7,775,827	(622,941)	8,398,768
Total Receipts	<u>22,421,030</u>	<u>116,897</u>	<u>22,304,133</u>
Expenditures:			
Municipal Electric Utility	17,776,682	7,098,329	10,678,353
Municipal Water Utility	1,490,498	326,413	1,164,085
Municipal Communications Utility	5,772,135	948,043	4,824,092
Total Expenditures	<u>25,039,315</u>	<u>8,372,785</u>	<u>16,666,530</u>
Net Change in Net Assets	(2,618,285)	(8,255,888)	5,637,603
Net Assets at Beginning of Year	<u>25,723,701</u>	<u>27,823,963</u>	<u>53,547,664</u>
Net Assets at End of Year	<u>\$ 23,105,416</u>	<u>\$ 19,568,075</u>	<u>\$ 59,185,267</u>

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION –
BUDGETARY REPORTING
YEAR ENDED DECEMBER 31, 2006**

The budgetary comparison is presented as Required Supplementary Information in accordance with Government Accounting Standards Board Statement No. 41 for governments with significant budgetary perspective differences resulting from not being able to present budgetary comparisons for each individual utility.

In accordance with the Code of Iowa, Spencer Municipal Utilities annually adopts a combined budget on the cash basis for the Municipal Electric Utility, Municipal Water Utility, and Municipal Communications Utility of the City of Spencer, Iowa following required public notice and hearing. The annual budget may be amended during the year utilizing similar statutorily prescribed procedures. Encumbrances are not recognized and appropriations lapse at year-end.

Formal and legal budgetary control is based upon nine major classes of disbursements, known as functions, not by fund. These functions are public safety, public works, health and social services, culture and recreation, community and economic development, general government, debt service, capital projects, and business type activities. All Utility disbursements are included in business type activities function and are required to be budgeted. During the year, one budget amendment decreased budgeted disbursements by \$164,266. This budget amendment is reflected in the final budgeted amounts.

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**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Board of Trustees
Spencer Municipal Utilities – Municipal Electric Utility
Spencer, IA 51301

We have audited the financial statements of the Municipal Electric Utility of the City of Spencer, Iowa (the Utility) as of and for the year ended December 31, 2006, and have issued our report thereon dated March 20, 2007. We conducted our audit in accordance with U.S. generally accepted auditing standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit we considered the Utility's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the utility's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the utility's financial statements that is more than inconsequential will not be prevented or detected by the utility's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the utility's internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable material weaknesses. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Utility's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Comments involving statutory and other legal matters about the Utility's operations for the year ended December 31, 2006 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Utility. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.

This report, a public record by law, is intended solely for the information and use of the officials and employees of Spencer Municipal Utilities, the citizens of the City of Spencer and other parties to whom Spencer Municipal Utilities may report. This report is not intended to be and should not be used by anyone other than these specified parties.

Williams + Company, P.C.
Certified Public Accountants

Spencer, Iowa
March 20, 2007

**SPENCER MUNICIPAL UTILITIES
MUNICIPAL ELECTRIC UTILITY
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2006**

Part I: Findings Related to the Financial Statements

No matters were noted.

**SPENCER MUNICIPAL UTILITIES
MUNICIPAL ELECTRIC UTILITY
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2006**

Part II: Other Findings Related to Required Statutory Reporting

II-A-06 Certified Budget – Disbursements during the year ended December 31, 2006 did not exceed the amounts budgeted in the business type activities function.

II-B-06 Questionable Expenditures – No expenditures were noted which did not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

II-C-06 Travel Expenses – No expenditures of the Utility's money for travel expenses of spouses of Utility's officials or employees were noted.

II-D-06 Business Transactions – Business transactions between Utility and Utility officials and employees are detailed as follows:

<u>Name, Title and Business Connection</u>	<u>Transaction Description</u>	<u>Amount</u>
Tom Howe, Board Member Part owner of H & N Chevrolet	Maintenance & Repairs	\$ 3,248
Dave Hultgren, Board Member Owner, Northwest Equipment	Maintenance & Repairs	\$ 467
Rachel, Rebecca and Ryan Florke Children of employee	Cleaning Services	\$ 1,838

In accordance with Chapter 362 5(10) of the Code of Iowa, the transactions with Board Member Howe do not appear to represent conflicts of interest since competitive bids were accepted in regard to maintenance and repairs. The transactions with Board Member Hultgren and for cleaning services do not appear to represent conflicts of interest since total transactions with each were less than \$1,500 during the year.

II-E-06 Bond Coverage – Surety bond coverage of Spencer Municipal Utilities' officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to insure that the coverage is adequate for current operations.

II-F-06 Board Minutes – No transactions were found that we believe should have been approved in the Board minutes but were not.

II-G-06 Revenue Bonds – As of December 31, 2006, the Utility had complied with all significant financial requirements related to its Electric Revenue Bonds, Series 2000, and Electric Revenue Bonds, Series 2004.

II-H-06 Deposits and Investments – No instances of non-compliance with the deposit and investment provisions of Chapter 12(B) and 12(c) of the Code of Iowa and the Utility's investment policy were noted.

SPENCER MUNICIPAL UTILITIES

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA**

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INDEPENDENT AUDITORS' REPORT

Board of Trustees
Spencer Municipal Utilities – Municipal Water Utility
Spencer, IA 51301

We have audited the accompanying balance sheet of the Municipal Water Utility of the City of Spencer, Iowa (the Utility) as of December 31, 2006 and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Utility's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Utility as of December 31, 2006, and the respective changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 20, 2007 on our consideration of the Utility's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis and budgetary comparison information on pages 31 through 33 and 48 through 50 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurements and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Williams & Company, P.C.
Certified Public Accountants

Spencer, Iowa
March 20, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

The purpose of Management's Discussion and Analysis (MD&A) is to provide the reader with an introduction to the financial statements. Our discussion and analysis of the Municipal Water Utility (Utility) of the City of Spencer, Iowa's financial performance provides an overview of the Utility's financial activities for the year ended December 31, 2006.

The following information should be read in conjunction with the financial statements and the accompanying notes to the financial statements that follow this section.

2006 Financial Highlights

The Utility delivered approximately 471,755,000 gallons of water to its retail customers in 2006 compared to approximately 460,302,000 gallons in 2005.

The Utility's net assets increased by \$89,023 to \$7,231,821 as a result of operations for the year ended December 31, 2006.

Overview of the Financial Statements

The balance sheet includes the Utility's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities).

The statement of revenues, expenses and changes in net assets report all revenues and expenses incurred during the fiscal year.

The statements of cash flows present cash receipts, cash disbursements, and net changes in cash resulting from operations, capital and related financing activities and investing activities.

The notes to the financial statements provide the required disclosures and other information that is necessary to give the reader a complete understanding of the data provided in the statements. The notes present information about the Utility's accounting policies, material risks, obligations, commitments, contingencies and subsequent events.

MANAGEMENT'S DISCUSSION AND ANALYSIS – Continued

Condensed Financial Information

The following condensed financial information serves as the key financial data and indicators for management, monitoring, and planning.

Condensed Balance Sheet

	<u>2006</u>	<u>2005</u>
Current assets	\$2,852,802	\$3,390,846
Capital assets, net of depr.	4,924,548	4,607,674
Noncurrent assets	<u>1,208,285</u>	<u>1,014,320</u>
Total assets	<u>8,985,635</u>	<u>9,012,840</u>
Current liabilities	597,814	651,042
Long-term debt	<u>1,156,000</u>	<u>1,219,000</u>
Total liabilities	<u>1,753,814</u>	<u>1,870,042</u>
Investments in capital assets, net of related debt	3,705,548	3,342,994
Restricted	195,189	194,108
Unrestricted	<u>3,331,084</u>	<u>3,606,696</u>
Total net assets	<u>7,231,821</u>	<u>7,142,798</u>
Total liabilities and net assets	<u>\$8,985,635</u>	<u>\$9,012,840</u>

Condensed Statement of Revenues, Expenses and Changes in Net Assets

	<u>2006</u>	<u>2005</u>
Sales of water	\$ 984,667	\$ 865,532
Other	<u>33,243</u>	<u>38,022</u>
Total operating revenue	<u>1,017,910</u>	<u>903,554</u>
System operation & maintenance	653,296	611,618
Depreciation & amortization	297,662	263,034
Customer service & administration	<u>119,372</u>	<u>114,187</u>
Total operating expenses	<u>1,070,330</u>	<u>988,839</u>
Operating income (loss)	(52,420)	(85,285)
Interest income	112,253	122,255
Interest expense	(47,591)	(49,203)
Other income (expense)	<u>76,781</u>	<u>215,649</u>
Total non-operating revenues	<u>141,443</u>	<u>288,701</u>
Change in net assets	89,023	203,416
Net assets, beginning of year	<u>7,142,798</u>	<u>6,939,382</u>
Net assets, end of year	<u>\$7,231,821</u>	<u>\$7,142,798</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS – Continued

Financial Analysis

The Utility's total assets decreased by approximately \$27,000.

The Utility's gross revenues increased by approximately \$119,000 or 13.22%.

Total operating expenses increased by approximately \$47,000 due to increased expenses related to the water plant operation and maintenance and distribution maintenance.

Total operating loss generated in 2006 was \$52,420 compared to \$85,285 in 2005.

Utility non-operating income (expense) resulted in additional income of \$141,443 during the year ended December 31, 2006. Contributions in Aid of Construction totaled \$105,614 for the year ended December 31, 2006 compared to \$249,138 for the year ended December 31, 2005.

The Utility had a net income of \$89,023 for the year ended December 31, 2006 compared to \$203,415 for the year ended December 31, 2005.

Capital Assets and Debt Administration

Net capital assets increased by approximately \$316,000 due to construction of water mains during the year ended December 31, 2006.

Economic Factors

During the year ended December 31, 2006, the Utility experienced a net income due to significant Contributions in Aid of Construction. Because of the net operating loss, the Board of Trustees adopted a rate adjustment effective with consumption beginning February 26, 2007. This rate adjustment will increase revenues by approximately \$110,000.

Contacting the Utility's Financial Management

This financial report is designed to present our citizens, customers, and creditors with a general overview of the Utility's finances and operating activities. If you have any questions or require additional information please contact the Business Manager, 712 Grand Ave, PO Box 222, Spencer, Iowa 51301.

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**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
BALANCE SHEET
DECEMBER 31, 2006**

ASSETS

Capital Assets:

Plant in Service	\$ 10,376,587
Accumulated Depreciation	(5,566,598)
Net Plant in Service	<u>4,809,989</u>
Construction in Progress	<u>114,559</u>

Total Capital Assets

4,924,548

Noncurrent Assets:

Cash and Cash Equivalents	
Restricted	195,189
Noncurrent Investments	
Board Designated	<u>1,000,000</u>

Total Noncurrent Assets

1,195,189

Current Assets:

Cash and Cash Equivalents	
Unrestricted	381,282
Board Designated	2,098,106
Accounts Receivable (Net of Allowance for Doubtful	
Accounts of \$5,000)	241,894
Unbilled Usage	37,494
Materials And Supplies Inventory	87,502
Prepayments and Other	<u>6,524</u>

Total Current Assets

2,852,802

Deferred Costs:

Unamortized Bond Issue Costs	<u>13,096</u>
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Total Assets

\$ 8,985,635

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
BALANCE SHEET
DECEMBER 31, 2006**

LIABILITIES AND NET ASSETS

Bonds Payable:	
Bonds Payable	1,219,000
Less - Current Maturities	<u>(63,000)</u>
Total Bonds Payable	<u>1,156,000</u>
Current Liabilities:	
Accounts Payable	484,196
Payroll and Sales Tax Payable	14,315
Accrued Payroll and Compensated Absences	28,341
Accrued Interest Payable	7,962
Current Maturities of Long-Term Debt	<u>63,000</u>
Total Current Liabilities	<u>597,814</u>
Total Liabilities	<u>1,753,814</u>
Net Assets	
Invested in Capital Assets, Net of Related Debt	3,705,548
Restricted	195,189
Unrestricted	<u>3,331,084</u>
Total Net Assets	<u>7,231,821</u>
Total Liabilities and Net Assets	<u><u>\$ 8,985,635</u></u>

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**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
STATEMENT OF REVENUES, EXPENSES AND
CHANGES IN FUND NET ASSETS
FOR THE YEAR ENDED DECEMBER 31, 2006**

Operating Revenues:	
Residential	\$ 782,464
Commercial	202,203
Rental Income	32,872
Miscellaneous	371
	<hr/>
Total Operating Revenues	1,017,910
Operating Expenses:	
Treatment	383,420
Distribution	269,876
Depreciation and Amortization	297,662
Customer Operations	52,175
General and Administrative	67,197
	<hr/>
Total Operating Expenses	1,070,330
Operating Loss	(52,420)
Non-Operating Income (Expense):	
Interest Income on Investments	112,253
Contributions From Developers	105,614
Leased Facilities	9,141
Interest Expense	(47,591)
Bond Amortization Expense	(1,224)
Gain on Plant Retirements	8,190
Payment in Lieu of Property Taxes	(44,940)
	<hr/>
Total Non-Operating Income (Expense)	141,443
Change in Net Assets	89,023
Net Assets at Beginning of Year	7,142,798
	<hr/>
Net Assets at End of Year	\$ 7,231,821

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2006**

Cash Flows From Operating Activities:

Cash Received From Customers	\$ 936,887
Cash Payments to Suppliers for Goods and Services	(757,824)
Cash Payments to Employees for Services	(69,021)

Net Cash Provided By Operating Activities	110,042
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Cash Flows From Noncapital Financing Activities:

Payment in Lieu of Property Taxes	(44,940)
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Net Cash (Used) By Noncapital Financing Activities	(44,940)
---	-----------------

**Cash Flows From Capital and Related
Financing Activities:**

Acquisition & Construction of Property and Equipment	(509,733)
Cash Received from Sale of Land	9,000
Revenue Bond Principal Repayment	(61,000)
Payments Received From Leasing of Facilities	9,141
Interest Paid	(47,980)

Net Cash (Used) By Capital and Related Financing Activities	(600,572)
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Cash Flows From Investing Activities:

Interest Received From Investments	112,253
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Net Cash Provided By Investing Activities	112,253
--	----------------

Net (Decrease) in Cash	(423,217)
-------------------------------	------------------

Cash at Beginning of Year	3,097,794
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Cash at End of Year	\$ 2,674,577
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Reconciliation:

Cash and Cash Equivalents

Unrestricted	\$ 381,282
Restricted	195,189
Board Designated	2,098,106

	\$ 2,674,577
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**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
STATEMENTS OF CASH FLOWS (CONTINUED)
FOR THE YEAR ENDED DECEMBER 31, 2006**

**Reconciliation of Operating Income to Net
Cash Provided by Operating Activities**

Operating Loss	\$ (52,420)
Adjustments to Reconcile Operating Income to Net Cash Provided By Operating Activities	
Depreciation and Amortization	297,662
(Increase) Decrease in Operating Assets:	
Accounts Receivable	(51,825)
Unbilled Usage	(3,483)
Materials and Supplies Inventory	(25,715)
Prepayments	661
Increase (Decrease) in Operating Liabilities:	
Accounts Payable	(60,121)
Accrued Payroll and Compensated Absences	(1,824)
Accrued Expenses	7,107
Total Adjustments	<u>162,462</u>
Net Cash Provided By Operating Activities	<u><u>\$ 110,042</u></u>

See Accompanying Notes to Financial Statements

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Organization and Basis of Accounting

The Municipal Water Utility of the City of Spencer, Iowa (Water Utility or Utility) operates as an independent unit of the City of Spencer and is managed, along with the Municipal Electric Utility and the Municipal Communication Utility of the City of Spencer, Iowa by a five member Board of Trustees.

The Utility follows the accounting practices prescribed through the Federal Energy Regulatory Commission for regulated utilities and proprietary fund accounting for governmental entities under accounting principles generally accepted in the United States of America.

For financial reporting purposes, the Utility has included all funds. The Utility has also considered all potential component units for which it is financially accountable, and other organizations for which the nature and significance of their relationship with the Utility are such that exclusion would cause the Utility's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the Utility to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific financial burdens on the Utility. It was determined that the Utility has no component units.

The Utility is not considered to be a component unit of the City of Spencer for financial statement purposes. An audit of the City of Spencer for the year ended June 30, 2006 has been completed and is filed under separate cover.

The Utility's financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

In reporting the financial activity of its enterprise fund, the Utility applies all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedure.

The Utility distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Utility's principal ongoing operations. The principal operating revenues of the Utility are charges to customers for sales and services. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

B. Capital Assets and Depreciation

Capital assets are stated at original cost when first devoted to public service. Currently, such costs include labor-related expenditures, such as payroll taxes, pensions, and other fringe benefits and administrative costs for labor related to the construction of new water facilities. In addition, net interest costs on construction debt are capitalized.

Replacements and betterments of capital assets are charged to capital assets. Routine maintenance and repairs are charged to expense as incurred.

Depreciation is provided on a straight-line basis. Current depreciation expense is approximately 2.84% of the original cost of depreciable water plant in service.

The estimated useful lives used to depreciate assets by class are as follows:

Infrastructure	40 years
Buildings and Equipment	5-20 years
Vehicles	5 years

C. Accounts Receivable

Accounts receivable are stated at the amount the Utility expects to collect from outstanding balances. The Utility provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after the Utility has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. Changes in the valuation allowance have not been material to the financial statements.

D. Inventories

Inventories are valued at the lower of cost or market. The average cost method is used for determining the cost of materials and supplies inventory. Inventories are recorded as an expenditure or, if applicable, capitalized when consumed.

E. Unamortized Bond Issue Costs

Unamortized debt issue costs are amortized over the life of the debt on a straight line basis which approximates the effective interest method.

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

F. Net Assets

Net assets represent the difference between assets and liabilities in the financial statements. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used for acquisition, construction or improvement of those assets and increased by unspent debt when there are limitations imposed on their use through external restrictions imposed by creditors, grantors or laws or regulations of other governments.

The Utility's policy is to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

G. Income Taxes

The Water Utility is exempt from federal and state income taxes because it is a governmental entity organized under the provisions of Chapter 388 of the Code of Iowa.

H. Revenues and Unbilled Usage

Revenues are based on billing rates, which are applied to customers' consumption of water. The Utility records estimated unbilled revenue at the end of accounting periods. Revenues earned, but not yet billed at December 31, 2006, totaled \$37,494.

I. Estimates

The preparation of the financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

Note 2 - CASH AND CASH EQUIVALENTS AND NONCURRENT INVESTMENTS

The Utility's deposits in bank at December 31, 2006 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

The Utility is authorized by statute and Board of Trustees' approval to invest public funds in obligations of the United States government, its agencies and instrumentalities; certificates of deposit and other evidences of deposit at federally insured Iowa depository institutions; and the Iowa Public Agency Investment Trust.

The Utility had investments in Iowa Public Agency Investment Trust which are valued at an amortized cost of \$1,309,858 pursuant to Rule 2a-7 under the Investment Company Act of 1940.

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 2 - CASH AND CASH EQUIVALENTS AND NONCURRENT INVESTMENTS (Continued)

Interest Rate Risk – The Utility's investment policy limits the investment of operating funds (funds expected to be expended in the current budget year or within 15 months of receipt) in instruments that mature within 397 days. Funds not identified as operating funds may be invested in investments with maturities longer than 397 days, but the maturities shall be consistent with the needs and use of the Utility.

Credit Risk – The Utility's investment in the Iowa Public Agency Investment Trust is unrated.

The Utility considers all highly liquid investments with an original maturity of three months or less to be cash equivalents for purposes of the statement of cash flows.

Investments are recorded at cost which approximates market. Adjustments are made to cost for any premium or discount, which is amortized over the maturity of the investment. Adjustments are also made to account for the change in accrued interest on respective investments.

Reconciliation of the Utility's cash and cash equivalents and noncurrent investments is as follows:

Cash and cash equivalents:	
Board designated	\$ 2,098,106
Restricted	195,189
Unrestricted	381,282
Total cash and cash equivalents	<u>2,674,577</u>
Noncurrent investments:	
Board designated	1,000,000
Total noncurrent investments	<u>1,000,000</u>
Total cash and cash equivalents and noncurrent investments	<u><u>\$ 3,674,577</u></u>

Note 3 - BOARD DESIGNATED FUNDS

The Board of trustees of the Utility has designated certain funds to be placed in a contingency reserve account. These funds, which are from unrestricted net assets, are being designated for contingencies such as a natural disaster and cannot be expended without Board approval.

The Board of Trustees of the Utility has designated certain funds to be placed in a replacement and construction reserve account. These funds, which are from unrestricted net assets, are being designated for replacement of property, plant, and equipment and for new construction. These funds cannot be expended without Board approval.

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 3 - BOARD DESIGNATED FUNDS (Continued)

Assets of the funds as of December 31, 2006 are summarized as follows:

	Contingency Reserve	Replacement and Construction Reserve	Total
Cash and cash equivalents	\$ 469,106	\$ 1,629,000	\$ 2,098,106
Noncurrent investments	-	1,000,000	1,000,000
Total	\$ 469,106	\$ 2,629,000	\$ 3,098,106

Note 4 - CAPITAL ASSETS

Capital assets activity for the year ended December 31, 2006 was as follows:

	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital assets not being depreciated:				
Land	\$ 259,344	\$ -	\$ (811)	\$ 258,533
Construction in progress	2,992	353,594	(344,384)	12,202
Total capital assets not being depreciated	262,336	353,594	(345,195)	270,735
Capital assets being depreciated:				
Infrastructure	5,729,706	560,565	-	6,290,271
Buildings and equipment	3,733,654	45,572	-	3,779,226
Vehicles	150,914	-	-	150,914
Total capital assets being depreciated	9,614,274	606,137	-	10,220,411
Less accumulated depreciation	5,268,936	297,662	-	5,566,598
Total capital assets being depreciated - net	4,345,338	308,475	-	4,653,813
Capital assets -- net	\$ 4,607,674	\$ 662,069	\$ (345,195)	\$ 4,924,548

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 5 - SEWER, STORM WATER, AND SOLID WASTE

The Electric Utility bills and collects sewer, storm water, and solid waste revenues for the City of Spencer. The resulting receivable and corresponding payable are recorded under the Water Utility. The City of Spencer reimburses the Electric Utility for these services

Note 6 - TRANSFERS IN LIEU OF PROPERTY TAXES

By resolution of the Board of Trustees, voluntary transfers in lieu of property taxes are made to the City of Spencer, Iowa. Currently, transfers approximate 5% of gross sales. Additionally, funds declared to be surplus can be, and have been, transferred to the City.

Note 7 - BONDS PAYABLE

Bonds payable activity for the year ended December 31, 2006 was as follows:

	Beginning			Ending	Amounts
	Balance	Additions	Reductions	Balance	Due Within One Year
Series 2001 revenue bonds	\$ 1,280,000	\$ -	\$ 61,000	\$1,219,000	\$ 63,000
Total revenue bonds	\$ 1,280,000	\$ -	\$ 61,000	\$1,219,000	\$ 63,000

The Series 2000 revenue bonds require annual principal payments, due December 1, and semiannual interest payments, due June 1 and December 1. Interest rate throughout the term of the bonds is 3.84%. The bonds are secured by the future net revenues of the Utility. Long-term debt matures and bears interest as follows:

	Series 2000	
	Principal	Interest
2007	\$ 63,000	\$ 46,810
2008	65,000	44,390
2009	68,000	41,894
2010	70,000	39,283
2011	73,000	36,595
2012-2016	410,000	138,624
2017-2021	470,000	53,606
Total	\$ 1,219,000	\$ 401,203

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 7 – BONDS PAYABLE (Continued)

The bond resolutions provide certain covenants relating to the collection, segregation, and distribution of revenues from customers; places certain restrictions on future borrowing and leasing or disposition of assets; and requires that minimum insurance coverage be maintained.

Restricted Funds

Outstanding Water Revenue Bonds are collateralized by the revenue of the Utility and the various special funds established by bond covenants. The covenants provide that the revenue of the Utility is to be used first to pay operating and maintenance expenses of the system and second to establish and maintain the special funds. Remaining revenues may then be used for any lawful purpose. The covenants also contain provisions which, among other items, restrict the issuance of additional revenue bonds unless the special funds noted above contain the required amounts and certain financial ratios are met. The Utility is in compliance with all significant financial requirements as of December 31, 2006.

At December 31, 2006, the special funds consisted of the following:

	<u>Total</u>
Bond Sinking Fund	\$ 80,189
Bond Reserve Fund	<u>115,000</u>
Total	<u>\$ 195,189</u>

Monthly deposits into the bond sinking fund are required to establish the amount necessary to pay the next installments of principal and interest. The bond reserve fund at December 31, 2006 equaled the required balance; therefore monthly deposits into the fund are not currently required. These funds may be used to pay principal and interest payments when insufficient funds are available in the sinking fund.

Note 8 - RATE MATTERS

Rates of the Utility are established by the Board of Trustees and, as a municipal system, are not subject to the regulation of the Utilities Division of the Department of Commerce of the State of Iowa.

Note 9 - NUMBER OF METER CONNECTIONS

The number of meter connections totaled 5,611 at December 31, 2006.

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 10 - LEASES

The Utility leases building space to the Electric Utility and Communication Utility. The revenues from such leases are classified as leased facilities. The leases are monthly leases based on building space utilized and totaled \$9,974 in 2006. No amount is receivable at December 31, 2006.

The Utility lease bandwidth and building space from the Electric Utility. The expense from such leases is classified as operating expense. The lease is a 20-year variable lease based on bandwidth and space utilized and totaled \$21,120 in 2006. No amount is payable at December 31, 2006.

Note 11 - RETIREMENT SYSTEM

IPERS

The Utility contributes to the Iowa Public Employees Retirement System (IPERS) which is a cost-sharing, multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits which are established by state statute to plan member and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, PO Box 9117, Des Moines, Iowa, 50306-9117.

Plan members are required to contribute 3.7% of their annual covered salary and the Utility is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The Utility's contributions to IPERS for the years ended December 31, 2006, 2005 and 2004 were \$15,922, \$14,133 and \$12,341, respectively, equal to the required contributions for each year.

EMPLOYEES PENSION PLAN

All full-time employees of the Water Utility who have completed six months of continuous employment and are 21 years of age are eligible to participate in a Money Accumulation Pension Plan administered by Copeland Plan Services. The Plan is a defined contribution plan of the money purchase type, intended to qualify under Internal Revenue Service Code Section 401(a), funded by a combination of employee and employer contributions. Employees electing to participate are required to contribute 2% of their compensation, and they may contribute an additional amount of not less than 1% and not more than 10% of their compensation. The Utility contributes 8% of the employees' compensation for all employees electing to participate.

The Water Utility's contribution to the Money Accumulation Pension Plan for 2006 totaled \$21,519.

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 12 - RISK MANAGEMENT

The Water Utility is exposed to various risks of loss related to torts; theft, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by the purchase of commercial insurance. The Utility assumes liability for any deductible and claims in excess of coverage limitations. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

Note 13 - RELATED PARTIES

The Electric Utility, Water Utility, and Communications Utility of the City of Spencer, Iowa exchange services in the normal course of business.

Two members of the Board of Trustees hold non-controlling interests in a financial institution where the Utility maintains cash balances

Additional related party items are included in Note 10.

Note 14 - COMMITMENTS

During 2005 and 2006, the Water Utility entered into a construction contract totaling approximately \$448,790 for maintenance to the distribution system to be completed in 2006 and 2007. \$403,431 was paid as of December 31, 2006.

During 2006, the Water Utility entered in a construction contract totaling \$386,284 for construction of the southwest feeder water main extension to be completed in 2007. No payments have been made as of December 31, 2006.

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
SCHEDULE OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCE, BUDGET AND ACTUAL, ALL
GOVERNMENTAL FUNDS AND PROPRIETARY FUND - CASH BASIS
FOR YEAR ENDED DECEMBER 31, 2006**

	Budgeted Amounts		Actual	Final to Actual Variance
	Original	Amended		
Receipts:				
Municipal Electric Utility			\$ 13,577,922	
Municipal Water Utility			1,067,281	
Municipal Communications Utility			7,775,827	
Total Receipts	\$ 20,622,000	\$ 23,359,250	22,421,030	\$ 938,220
Expenditures:				
Municipal Electric Utility			17,776,682	
Municipal Water Utility			1,490,498	
Municipal Communications Utility			5,772,135	
Total Expenditures	25,497,730	25,333,464	25,039,315	294,149
Excess (Deficiency) of Revenues Over Expenditures	(4,875,730)	(1,974,214)	(2,618,285)	644,071
Other Financing Sources (Uses);				
Transfers In	-	-	-	-
Transfers Out	(2,000,000)	(2,250,000)	-	(2,250,000)
Total Other Financing Sources (Uses)	(2,000,000)	(2,250,000)	-	(2,250,000)
Net Change in Net Assets	(6,875,730)	(4,224,214)	(2,618,285)	(1,605,929)
Net Assets at Beginning of Year	32,087,108	32,087,108	25,723,701	6,363,407
Net Assets at End of Year	\$ 25,211,378	\$ 27,862,894	\$ 23,105,416	\$ 4,757,478

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
BUDGET TO GAAP RECONCILIATION
FOR YEAR ENDED DECEMBER 31, 2006**

	Cash Basis	Accrual Adjustments	Accrual Basis
Receipts:			
Municipal Electric Utility	\$ 13,577,922	\$ 925,665	\$ 12,652,257
Municipal Water Utility	1,067,281	(185,827)	1,253,108
Municipal Communications Utility	7,775,827	(622,941)	8,398,768
Total Receipts	<u>22,421,030</u>	<u>116,897</u>	<u>22,304,133</u>
Expenditures:			
Municipal Electric Utility	17,776,682	7,098,329	10,678,353
Municipal Water Utility	1,490,498	326,413	1,164,085
Municipal Communications Utility	5,772,135	948,043	4,824,092
Total Expenditures	<u>25,039,315</u>	<u>8,372,785</u>	<u>16,666,530</u>
Net Change in Net Assets	(2,618,285)	(8,255,888)	5,637,603
Net Assets at Beginning of Year	<u>25,723,701</u>	<u>27,823,963</u>	<u>53,547,664</u>
Net Assets at End of Year	<u>\$ 23,105,416</u>	<u>\$ 19,568,075</u>	<u>\$ 59,185,267</u>

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION –
BUDGETARY REPORTING
YEAR ENDED DECEMBER 31, 2006**

The budgetary comparison is presented as Required Supplementary Information in accordance with Government Accounting Standards Board Statement No. 41 for governments with significant budgetary perspective differences resulting from not being able to present budgetary comparisons for each individual utility.

In accordance with the Code of Iowa, Spencer Municipal Utilities annually adopts a combined budget on the cash basis for the Municipal Electric Utility, Municipal Water Utility, and Municipal Communications Utility of the City of Spencer, Iowa following required public notice and hearing. The annual budget may be amended during the year utilizing similar statutorily prescribed procedures. Encumbrances are not recognized and appropriations lapse at year-end.

Formal and legal budgetary control is based upon nine major classes of disbursements, known as functions, not by fund. These functions are public safety, public works, health and social services, culture and recreation, community and economic development, general government, debt service, capital projects and business type activities function and are required to be budgeted. During the year, one budget amendment decreased budgeted disbursements by \$164,266. This budget amendment is reflected in the final budgeted amounts.

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**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Board of Trustees
Spencer Municipal Utilities – Municipal Water Utility
Spencer, IA 51301

We have audited the financial statements of the Municipal Water Utility of the City of Spencer, Iowa (the Utility) as of and for the year ended December 31, 2006, and have issued our report thereon dated March 20, 2007. We conducted our audit in accordance with U.S. generally accepted auditing standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit we considered the Utility's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the utility's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the utility's financial statements that is more than inconsequential will not be prevented or detected by the utility's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the utility's internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable material weaknesses. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Utility's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Comments involving statutory and other legal matters about the Utility's operations for the year ended December 31, 2006 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Utility. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.

This report, a public record by law, is intended solely for the information and use of the officials and employees of Spencer Municipal Utilities, the citizens of the City of Spencer and other parties to whom Spencer Municipal Utilities may report. This report is not intended to be and should not be used by anyone other than these specified parties.

Williams & Company, P.C.
Certified Public Accountants

Spencer, Iowa
March 20, 2007

**SPENCER MUNICIPAL UTILITIES
MUNICIPAL WATER UTILITY
SCHEDULE OF FINDINGS
FOR THE YEAR ENDED DECEMBER 31, 2006**

Part I: Findings Related to the Financial Statements

No matters were noted.

**SPENCER MUNICIPAL UTILITIES
MUNICIPAL WATER UTILITY
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2006**

Part II: Other Findings Related to Required Statutory Reporting

II-A-06 Certified Budget – Disbursements during the year ended December 31, 2006 did not exceed the amounts budgeted in the business type activities function.

II-B-06 Questionable Expenditures – We noted no expenditures that we believe may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

II-C-06 Travel Expenses – No expenditures of Utility's money for travel expenses of spouses of Utility's officials or employees were noted.

II-D-06 Business Transactions – No business transactions between the Utility and Utility officials or employees were noted.

II-E-06 Bond Coverage – Surety bond coverage of Spencer Municipal Utilities' officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to insure that the coverage is adequate for current operations.

II-F-06 Board Minutes – No transactions were found that we believe should have been approved in the Board minutes but were not.

II-G-06 Revenue Bonds – As of December 31, 2006, the Utility is in compliance with all significant financial requirements related to its Water Revenue Bond, Series 2000.

II-H-06 Deposits and Investments – No instances of non-compliance with the deposit and investment provisions of Chapter 12(B) and 12(c) of the Code of Iowa and the Utility's investment policy were noted.

SPENCER MUNICIPAL UTILITIES
MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA

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INDEPENDENT AUDITORS' REPORT

Board of Trustees
Spencer Municipal Utilities -- Municipal Communications Utility
Spencer, IA 51301

We have audited the accompanying balance sheet of the Municipal Communications Utility of the City of Spencer, Iowa (the Utility) as of December 31, 2006 and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Utility's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Utility as of December 31, 2006, and the respective changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 20, 2007 on our consideration of the Utility's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis and budgetary comparison information on pages 56 through 58 and 70 through 72 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurements and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Williams & Company, P.C.
Certified Public Accountants

Spencer, Iowa
March 20, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

The purpose of Management's Discussion and Analysis (MD&A) is to provide the reader with an introduction to the financial statements. Our discussion and analysis of the Municipal Communications Utility (Utility) of the City of Spencer, Iowa's financial performance provides an overview of the Utility's financial activities for the year ended December 31, 2006.

The following information should be read in conjunction with the financial statements and the accompanying notes to the financial statements that follow this section.

2006 Financial Highlights

Total assets increased by approximately \$2,710,000 which was attributable to an increase in the cash balance, an investment in Clay County Communications, LLC, a 28E entity, and an increase in unbilled revenues. Total liabilities decreased by approximately \$878,000 due to payments on debt service.

Total net assets increased by \$3,574,676, the result of the utility operations.

Overview of the Financial Statements

The balance sheet includes the Utility's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities).

The statement of revenues, expenses and changes in net assets report all revenues and expenses incurred during the fiscal year.

The statements of cash flows present cash receipts, cash disbursements, and net changes in cash resulting from operations, capital and related financing activities and investing activities.

The notes to the financial statements provide the required disclosures and other information that is necessary to give the reader a complete understanding of the data provided in the statements. The notes present information about the Utility's accounting policies, material risks, obligations, commitments, contingencies and subsequent events.

MANAGEMENT'S DISCUSSION AND ANALYSIS – Continued

Condensed Financial Information

The following condensed financial information serves as the key financial data and indicators for management, monitoring, and planning.

Condensed Balance Sheet

	<u>2006</u>	<u>2005</u>
Current assets	\$ 5,832,195	\$ 3,179,644
Capital assets, net of depreciation	5,205,667	5,628,596
Noncurrent assets	<u>675,199</u>	<u>207,705</u>
Total assets	<u>11,713,061</u>	<u>9,015,945</u>
Current liabilities	768,493	646,053
Long-term debt	<u>5,546,000</u>	<u>6,546,000</u>
Total liabilities	<u>6,314,493</u>	<u>7,192,053</u>
Investments in capital assets, net of related debt	(315,152)	(917,404)
Unrestricted	<u>5,713,720</u>	<u>2,741,296</u>
Total net assets	<u>5,398,568</u>	<u>1,823,892</u>
Total liabilities and net assets	<u>\$11,713,061</u>	<u>\$ 9,015,945</u>

Condensed Statement of Revenues, Expenses and Changes in Net Assets

	<u>2006</u>	<u>2005</u>
Cable television revenue	\$ 1,008,293	\$ 896,456
Telephone revenue	6,077,336	4,414,616
Data revenue	<u>819,550</u>	<u>597,168</u>
Total operating revenue	<u>7,905,179</u>	<u>5,908,240</u>
System operation & maintenance	2,828,004	2,477,795
Depreciation & amortization	949,893	905,617
Customer service & administration	<u>696,057</u>	<u>569,579</u>
Total operating expenses	<u>4,473,954</u>	<u>3,952,991</u>
Operating income (loss)	3,431,225	1,955,249
Interest income	142,996	51,064
Interest expense	(277,665)	(314,127)
Other income (expense)	<u>278,120</u>	<u>288,091</u>
Total non-operating revenues	<u>143,451</u>	<u>25,028</u>
Change in net assets	3,574,676	1,980,277
Net assets, beginning of year	<u>1,823,892</u>	<u>(156,385)</u>
Net assets, end of year	<u>\$5,398,568</u>	<u>\$1,823,892</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS – Continued

Financial Analysis

The Utility's total assets increased by approximately \$2,710,000.

The Utility's gross revenues increased by approximately \$1,990,000 or 33.64%.

Total operating expenses increased by approximately \$502,000 because of increased expenses for cable programming, telephone long distance and an increase in the number of subscribers. Also, depreciation and amortization expense increased by approximately \$44,000.

Total operating income generated in 2006 was \$3,431,225 compared to \$1,955,249 in 2005.

The Utility had a net income of \$3,574,676 for the year ended December 31, 2006 compared to \$1,980,277 for the year ended December 31, 2005.

Capital Assets and Debt Administration

Net capital assets decreased by approximately \$414,000 due to depreciation expense being greater than capital purchases for the year ended December 31, 2006.

Economic Factors

The Utility continues to see positive growth in subscriber base and also net income. The Utility will be faced with increased costs of operating due to cable programming contracts.

Contacting the Utility's Financial Management

This financial report is designed to present our citizens, customers, and creditors with a general overview of the Utility's finances and operating activities. If you have any questions or require additional information please contact the Business Manager, 712 Grand Ave, PO Box 222, Spencer, Iowa 51301.

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**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
BALANCE SHEET
DECEMBER 31, 2006**

ASSETS

Current Assets:	
Cash and Cash Equivalents	\$ 3,751,202
Consumer Deposits	33,229
Accounts Receivable (Net of Allowance for Doubtful Accounts of \$30,000)	1,003,334
Unbilled Usage	883,060
Materials And Supplies Inventory	39,831
Prepayments and Other	<u>121,539</u>
Total Current Assets	<u>5,832,195</u>
Capital Assets:	
Property and Equipment	9,290,502
Accumulated Depreciation	<u>(4,084,835)</u>
Total Capital Assets	<u>5,205,667</u>
Deferred Costs:	
Unamortized FAS 51 Costs	<u>25,181</u>
Noncurrent Assets:	
Long-term Receivables	<u>650,018</u>
Total Assets	<u><u>11,713,061</u></u>

LIABILITIES AND NET ASSETS

Current Liabilities:	
Accounts Payable	661,984
Payroll and Sales Tax Payable	21,768
Accrued Payroll and Compensated Absences	51,512
Consumer Deposits	<u>33,229</u>
Total Current Liabilities	<u>768,493</u>
Notes Payable	
Note Payable	<u>5,546,000</u>
Total Liabilities	<u>6,314,493</u>
Net Assets	
Invested in Capital Assets, Net of Related Debt	(315,152)
Unrestricted	<u>5,713,720</u>
Total Net Assets	<u>5,398,568</u>
Total Liabilities and Net Assets	<u><u>\$ 11,713,061</u></u>

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
STATEMENT OF REVENUES, EXPENSES AND
CHANGES IN FUND NET ASSETS
FOR THE YEAR ENDED DECEMBER 31, 2006**

Operating Revenues:	
Cable System Revenue	\$ 1,005,714
Telephone System Revenue	6,076,880
Data Services Revenue	815,050
Miscellaneous Income	7,535
	<hr/>
Total Operating Revenues	7,905,179
Operating Expenses:	
Plant Specific and Programming	2,828,004
Depreciation and Amortization	949,893
Customer Services and Marketing	360,926
General and Administrative	335,131
	<hr/>
Total Operating Expenses	4,473,954
Operating Income	3,431,225
Non-Operating Income (Expense):	
Leased Facilities	350,593
Economic Development Payment	(20,000)
Interest Income	142,996
Interest Expense	(277,665)
Loss on Plant Retirements	(11,723)
Payment in Lieu of Property Taxes	(40,750)
	<hr/>
Total Non-Operating Income (Expense)	143,451
Changes in Net Assets	3,574,676
Net Assets at Beginning of Year	1,823,892
	<hr/>
Net Assets at End of Year	\$ 5,398,568
	<hr/>

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2006**

Cash Flows From Operating Activities:

Cash Received From Customers	\$ 7,280,681
Cash Payments to Suppliers for Goods and Services	(3,090,498)
Cash Payments to Employees for Services	<u>(335,484)</u>

Net Cash Provided By Operating Activities	<u>3,854,699</u>
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Cash Flows From Noncapital Financing Activities:

Contributions Paid for Economic Development	(20,000)
Payment in Lieu of Property Taxes	<u>(40,750)</u>

Net Cash (Used) By Noncapital Financing Activities	<u>(60,750)</u>
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Cash Flows From Capital and Related

Financing Activities:

Acquisition & Construction of Property and Equipment	(535,449)
Proceeds from Sale of Capital Assets	1,557
Repayment of Long-term Debt	(1,000,000)
Payments Received From Leasing of Facilities	350,593
Interest Paid	<u>(277,664)</u>

Net Cash (Used) By Capital and Related Financing Activities	<u>(1,460,963)</u>
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Cash Flows From Investing Activities:

Other Investments	(472,290)
Interest Received From Investments	<u>142,996</u>

Net Cash (Used) By Investing Activities	<u>(329,294)</u>
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Net Increase in Cash	2,003,692
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Cash at Beginning of Year	<u>1,747,510</u>
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Cash at End of Year	<u><u>\$ 3,751,202</u></u>
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**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
STATEMENTS OF CASH FLOWS (CONTINUED)
FOR THE YEAR ENDED DECEMBER 31, 2006**

**Reconciliation of Operating Income to Net
Cash Provided by Operating Activities**

Operating Income	\$ 3,431,225
Adjustments to Reconcile Operating Income to Net Cash Provided By Operating Activities	
Depreciation and Amortization	949,893
(Increase) Decrease in Operating Assets:	
Consumer Deposits	805
Accounts Receivable	(8,298)
Unbilled Usage	(617,005)
Materials and Supplies Inventory	5,783
Prepayments	(30,144)
Increase (Decrease) in Operating Liabilities:	
Accounts Payable	115,916
Accrued Payroll and Compensated Absences	(353)
Consumer Deposits	(805)
Accrued Expenses	7,682
Total Adjustments	<u>423,474</u>
Net Cash Provided By Operating Activities	<u><u>\$ 3,854,699</u></u>

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Organization and Basis of Accounting

The Municipal Communications Utility of the City of Spencer, Iowa (Communications Utility or Utility) operates as an independent unit of the City of Spencer and is managed, along with the Municipal Electric Utility and the Municipal Water Utility of the City of Spencer, Iowa, by a five member Board of Trustees. The Utility was formed to engage in the development and operation of a broadband communications system and the marketing of related services such as cable television, telephone, and high-speed data communications. The Utility's rates are set by its governing board.

For financial reporting purposes, the Utility has included all funds. The Utility has also considered all potential component units for which it is financially accountable, and other organizations for which the nature and significance of their relationship with the Utility are such that exclusion would cause the Utility's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the Utility to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific financial burdens on the Utility. It was determined that the Utility has no component units.

The Utility is not considered to be a component unit of the City of Spencer for financial statement purposes. An audit of the City of Spencer for the year ended June 30, 2006 has been completed and is filed under separate cover.

The Utility's financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

In reporting the financial activity of its enterprise fund, the Utility applies all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure.

The Utility distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Utility's principal ongoing operations. The principal operating revenues of the Utility are charges to customers for sales and services. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

B. Capital Assets and Depreciation

Capital assets are stated at original cost when first devoted to public service. Currently, such costs include labor-related expenditures, such as payroll taxes, pensions, and other fringe benefits and administrative costs for labor related to the construction of new communications facilities. In addition, net interest costs on construction debt are capitalized. Replacements and betterments of capital assets are charged to capital assets. Routine maintenance and repairs are charged to expense as incurred. Depreciation is calculated on the straight-line basis. Current depreciation expense is approximately 10.15% of the original cost of depreciable communication plant in service.

The estimated useful lives used to depreciate assets by class are as follows:

Infrastructure	10-15 years
Buildings and improvements	20 years
Equipment	5-7 years

C. Accounts Receivable

Accounts receivable are stated at the amount the Utility expects to collect from outstanding balances. The Utility provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowed based on its assessment of the current status of individual accounts. Balances that are still outstanding after the Utility has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. Changes in the valuation allowance have not been material to the financial statements.

D. Inventories

Inventories are valued at the lower of cost or market. The average cost method is used for determining the cost of materials and supplies inventory. Inventories are recorded as an expenditure or, if applicable, capitalized when consumed.

E. Unamortized Deferred Costs

Cable television system costs allocated during construction of the system are being amortized using the straight-line method over the expected life of the cable television plant.

F. Net Assets

Net assets represent the difference between assets and liabilities in the financial statements. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used for acquisition, construction or improvement of those assets and increased by unspent debt when there are limitations imposed on their use through external restrictions imposed by creditors, grantors or laws or regulations of other governments.

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Utility's policy is to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

G. Income Taxes

The Communications Utility is exempt from federal and state income taxes because it is a governmental entity organized under the provisions of Chapter 388 of the Code of Iowa.

H. Revenues and Unbilled Usage

Revenues are based on billing rates, which are applied to customers' consumption of communications services. The Utility records estimated unbilled revenue at the end of accounting periods. Revenues earned, but not yet billed at December 31, 2006, totaled \$883,060.

I. Estimates

The preparation of the financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

Note 2 - CASH AND CASH EQUIVALENTS

The Utility's deposits in banks at December 31, 2006 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

The Utility is authorized by statute and Board of Trustees' approval to invest public funds in obligations of the United States government, its agencies, and instrumentalities; certificates of deposit and other evidences of deposit at federally insured Iowa depository institutions; and the Iowa Public Agency Investment Trust.

Interest Rate Risk – The Utility's investment policy limits the investment of operating funds (funds expected to be expended in the current budget year or within 15 months of receipt) in instruments that mature within 397 days. Funds not identified as operating funds may be invested in investments with maturities longer than 397 days, but the maturities shall be consistent with the needs and use of the Utility.

The Utility considers all highly liquid investments with an original maturity of three months or less to be cash equivalents for purposes of the statement of cash flows.

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 3 - CAPITAL ASSETS

Capital assets activity for the year ended December 31, 2006 was as follows:

	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital assets not being depreciated:				
Land	\$ 10,342	\$ -	\$ -	\$ 10,342
Total capital assets not being depreciated	10,342	-	-	10,342
Capital assets being depreciated:				
Infrastructure	7,921,938	345,731	-	8,267,669
Buildings and improvements	13,750	180,295	-	194,045
Equipment	831,160	9,421	(22,135)	818,446
Total capital assets being depreciated	8,766,848	535,447	(22,135)	9,280,160
Less accumulated depreciation	3,148,594	945,096	(8,855)	4,084,835
Total capital assets being depreciated - net	5,618,254	(409,649)	(13,280)	5,195,325
Capital assets - net	\$ 5,628,596	\$ (409,649)	\$ (13,280)	\$ 5,205,667

Note 4 - TRANSFERS IN LIEU OF PROPERTY TAX

By resolution of the Board of Trustees, voluntary transfers in lieu of property taxes are made to the City of Spencer, Iowa. Funds totaling \$40,750 were transferred to the City during 2006.

Note 5 - LONG-TERM RECEIVABLES

During December 2003, the Utility entered into an agreement with Northern Iowa Communications Partners, LLC (NICP), an Iowa limited company, pursuant to the provisions of Chapter 28E of the Code of Iowa. Under this agreement, the Utility, along with other members of NICP, agrees to pay for the use of a shared switch for routing certain telecommunications traffic at rates adopted by NICP. The Utility will share in profits generated or shortfalls incurred through the 28E agreement due to the method used to determine an annual usage fee paid by NICP to the Utility. An NICP member will be responsible for maintaining the financial records related to the 28E agreement. The amount earned but not received by the Utility of \$250,018 is recorded as a receivable.

During May 2006, the Utility entered into an agreement with Evertek, Inc., an Iowa Corporation, to create Clay County Communications as a separate legal entity. Clay County Communications shall function as if it were a limited liability company organized under Iowa Code Chapter 490A. The purpose of this agreement and Clay County Communications is to provide wired and/or wireless communications services in Clay County, Iowa. The Utility and Evertek, Inc. each initially contributed \$400,000. The Utility's contribution is recorded as a receivable.

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 6 – NOTE PAYABLE

Note payable activity for the year ended December 31, 2006 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Note Payable - Municipal Electric Utility	\$ 6,546,000	\$ -	\$ 1,000,000	\$ 5,546,000	\$ -

The Board of Trustees of the Municipal Electric Utility adopted a resolution on June 14, 1999, pursuant to Section 384.89 City Code of Iowa and Rule 2.5(5) of the rules promulgated by the City Finance Committee, allowing for the advance of funds not to exceed \$8,000,000 to the Municipal Communications Utility to be utilized for the construction and development of the communication system. These funds are to be repaid upon demand and bear a 4.5% per annum interest rate. No interest was payable at December 31, 2006. In January 2007, the Communications Utility repaid \$1,064,000 of the principal to the Electric Utility including \$20,798 of interest.

Note 7 - LEASES

The Utility leases building space from the Water Utility. The expense from the lease is classified as operating expense. The lease is a monthly lease based on building space utilized and totaled \$1,968 in 2006. At December 31, 2006, \$168 is recorded as a payable.

The Utility leases bandwidth, property, and building space from the Electric Utility. The expense from the lease is classified as operating expense. The lease is a 20-year variable lease based on bandwidth and space utilized and totaled \$386,337 in 2006. At December 31, 2006, \$1,129 is recorded as a payable.

Note 8 - RETIREMENT SYSTEM (Continued)

IPERS

The Utility contributes to the Iowa Public Employees Retirement System (IPERS) which is a cost-sharing, multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits which are established by state statute to plan members and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, PO Box 9117, Des Moines, Iowa, 50306-9117.

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 8 - RETIREMENT SYSTEM (Continued)

Plan members are required to contribute 3.70% of their annual covered salary and the Utility is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The Utility's contributions to IPERS for the years ended December 31, 2006, 2005 and 2004 were \$30,094, \$27,831 and \$32,050, respectively, equal to the required contributions for each year.

Employees Pension Plan

All full-time employees of the Communications Utility who have completed six months of continuous employment and are 21 years of age are eligible to participate in a Money Accumulation Pension Plan administered by Copeland Plan Services. The Plan is a defined contribution plan of the money purchase type, intended to qualify under Internal Revenue Service Code Section 401(a), funded by a combination of employee and employer contributions. Employees electing to participate are required to contribute 2% of their compensation, and they may contribute an additional amount of not less than 1% and not more than 10% of their compensation. The Utility contributes 8% of the employees' compensation for all employees electing to participate.

The Communications Utility's contribution to the Money Accumulation Pension Plan for 2006 totaled \$42,096.

Note 9 - RISK MANAGEMENT

The Communications Utility is exposed to various risks of loss related to torts; theft, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by the purchase of commercial insurance. The Utility assumes liability for any deductible and claims in excess of coverage limitations. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

Note 10 - RELATED PARTIES

The Electric Utility, Water Utility, and Communications Utility of the City of Spencer, Iowa exchange services in the normal course of business.

Two members of the Board of Trustees hold non-controlling interests in a financial institution where the Utility maintains cash balances.

Additional related party items are included in Notes 5, 6, and 7.

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006**

Note 11 - COMMITMENTS

The Utility has committed to provide annual support of \$28,000 to the Clay Regional Events center during 2007. The support is contingent on the Events Center receiving additional support from other area sources.

During 2005, the Communication Utility provided a letter of support to continue funding Iowa Great Lakes Corridor of Opportunity at a level of \$12,500 per year for four years.

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
BUDGETARY COMPARISON SCHEDULE OF RECEIPTS, DISBURSEMENTS
AND CHANGES IN NET ASSETS - BUDGET AND ACTUAL (CASH BASIS)
REQUIRED SUPPLEMENTARY INFORMATION
FOR YEAR ENDED DECEMBER 31, 2006**

	Budgeted Amounts		Actual	Final to Actual Variance
	Original	Amended		
Receipts:				
Municipal Electric Utility			\$ 13,577,922	
Municipal Water Utility			1,067,281	
Municipal Communications Utility			7,775,827	
Total Receipts	\$ 20,622,000	\$ 23,359,250	22,421,030	\$ 938,220
Expenditures:				
Municipal Electric Utility			17,776,682	
Municipal Water Utility			1,490,498	
Municipal Communications Utility			5,772,135	
Total Expenditures	25,497,730	25,333,464	25,039,315	294,149
Excess (Deficiency) of Revenues Over Expenditures	(4,875,730)	(1,974,214)	(2,618,285)	644,071
Other Financing Sources (Uses);				
Transfers In	-	-	-	-
Transfers Out	(2,000,000)	(2,250,000)	-	(2,250,000)
Total Other Financing Sources (Uses)	(2,000,000)	(2,250,000)	-	(2,250,000)
Net Change in Net Assets	(6,875,730)	(4,224,214)	(2,618,285)	(1,605,929)
Net Assets at Beginning of Year	32,087,108	32,087,108	25,723,701	6,363,407
Net Assets at End of Year	\$ 25,211,378	\$ 27,862,894	\$ 23,105,416	\$ 4,757,478

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
BUDGET TO GAAP RECONCILIATION
REQUIRED SUPPLEMENTARY INFORMATION
FOR YEAR ENDED DECEMBER 31, 2006**

	Cash Basis	Accrual Adjustments	Accrual Basis
Receipts:			
Municipal Electric Utility	\$ 13,577,922	\$ 925,665	\$ 12,652,257
Municipal Water Utility	1,067,281	(185,827)	1,253,108
Municipal Communications Utility	7,775,827	(622,941)	8,398,768
Total Receipts	<u>22,421,030</u>	<u>116,897</u>	<u>22,304,133</u>
Expenditures:			
Municipal Electric Utility	17,776,682	7,098,329	10,678,353
Municipal Water Utility	1,490,498	326,413	1,164,085
Municipal Communications Utility	5,772,135	948,043	4,824,092
Total Expenditures	<u>25,039,315</u>	<u>8,372,785</u>	<u>16,666,530</u>
Net Change in Net Assets	(2,618,285)	(8,255,888)	5,637,603
Net Assets at Beginning of Year	<u>25,723,701</u>	<u>27,823,963</u>	<u>53,547,664</u>
Net Assets at End of Year	<u>\$ 23,105,416</u>	<u>\$ 19,568,075</u>	<u>\$ 59,185,267</u>

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION --
BUDGETARY REPORTING
YEAR ENDED DECEMBER 31, 2006**

The budgetary comparison is presented as Required Supplementary Information in accordance with Government Accounting Standards Board Statement No. 41 for governments with significant budgetary perspective differences resulting from not being able to present budgetary comparisons for each individual utility.

In accordance with the Code of Iowa, Spencer Municipal Utilities annually adopts a combined budget on the cash basis for the Municipal Electric Utility, Municipal Water Utility, and Municipal Communications Utility of the City of Spencer, Iowa following required public notice and hearing. The annual budget may be amended during the year utilizing similar statutorily prescribed procedures. Encumbrances are not recognized and appropriations lapse at year-end.

Formal and legal budgetary control is based upon nine major classes of disbursements, known as functions, not by fund. These functions are public safety, public works, health and social services, culture and recreation, community and economic development, general government, debt service, capital projects and business type activities function and are required to be budgeted. During the year, one budget amendment decreased budgeted disbursements by \$164,266. This budget amendment is reflected in the final budgeted amounts.

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**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Board of Trustees
Spencer Municipal Utilities – Municipal Communications Utility
Spencer, IA 51301

We have audited the financial statements of the Municipal Communications Utility of the City of Spencer, Iowa (the Utility) as of and for the year ended December 31, 2006, and have issued our report thereon dated March 20, 2007. We conducted our audit in accordance with U.S. generally accepted auditing standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit we considered the Utility's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the utility's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the utility's financial statements that is more than inconsequential will not be prevented or detected by the utility's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the utility's internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable material weaknesses. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Utility's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Comments involving statutory and other legal matters about the Utility's operations for the year ended December 31, 2006 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Utility. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.

This report, a public record by law, is intended solely for the information and use of the officials and employees of Spencer Municipal Utilities, the citizens of the City of Spencer and other parties to whom Spencer Municipal Utilities may report. This report is not intended to be and should not be used by anyone other than these specified parties.

Williams & Company, P.C.
Certified Public Accountants

Spencer, Iowa
March 20, 2007

**SPENCER MUNICIPAL UTILITIES
MUNICIPAL COMMUNICATIONS UTILITY
SCHEDULE OF FINDINGS
FOR THE YEAR ENDED DECEMBER 31, 2006**

Part I: Findings Related to the Financial Statements

No matters were noted.

**SPENCER MUNICIPAL UTILITIES
MUNICIPAL COMMUNICATIONS UTILITY
SCHEDULE OF FINDINGS
FOR THE YEAR ENDED DECEMBER 31, 2006**

Part II: Other Findings Related to Required Statutory Reporting

II-A-06 Certified Budget – Disbursements during the year ended December 31, 2006 did not exceed the amounts budgeted in the business type activities function.

II-B-06 Questionable Expenditures – We noted no expenditures that we believe may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

II-C-06 Travel Expenses – No expenditures of Utility's money for travel expenses of spouses of Utility's officials or employees were noted.

II-D-06 Business Transactions – Business transactions between the Utility and Utility officials or employees are detailed as follows:

<u>Name, Title and Business Connection</u>	<u>Transaction Description</u>	<u>Amount</u>
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Tom Howe, Board Member Part owner of H & N Chevrolet	Maintenance & Repairs	\$ 628
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In accordance with Chapter 362.5(10) of the Code of Iowa, the transactions with the Board Member do not appear to represent a conflict of interest since the transactions were less than \$1,500 during the year.

II-E-06 Bond Coverage – Surety bond coverage of Spencer Municipal Utilities' officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to insure that the coverage is adequate for current operations.

II-F-06 Board Minutes – No transactions were found that we believe should have been approved in the Board minutes but were not.

II-G-06 Revenue Bonds – No revenue bonds/notes were issued to the Utility.

II-H-06 Deposits and Investments – No instances of non-compliance with the deposit and investment provisions of Chapter 12(B) and 12(c) of the Code of Iowa and the Utility's investment policy were noted.

II-I-06 Telecommunication Services – No instances of noncompliance with Chapter 388.10 of the Code of Iowa were noted.